No. 83-917

In the Supreme Court of the United States

October Term, 1983

NATALIE KROOG,

Petitioner,

vs.

STEVEN MAIT and PAINE, WEBBER, JACKSON & CURTIS, INC.,

Respondents.

On Writ of Certiorari
To the United States Court of Appeals
For the Seventh Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a state statute which directly conflicts with the Federal Arbitration Act by negating an otherwise "valid, irrevocable, and enforceable" arbitration agreement contained in a contract involving securities transactions in interstate commerce, must yield to the Federal Arbitration Act under the Supremacy Clause of the United States Constitution.

PARTIES BELOW

Plaintiff is a resident of Wisconsin. Defendant Steven Mait is a resident of New York. Defendant Paine Webber Jackson & Curtis Incorporated, a Delaware corporation, is a national securities firm with its principal office located in New York, New York. Defendant Paine Webber Jackson & Curtis Incorporated has no subsidiaries, except wholly-owned subsidiaries. Defendant is a wholly-owned subsidiary of Paine Webber, Incorporated, which has, as its principal subsidiaries, in addition to defendant, Blyth Eastman Paine Webber Incorporated, Paine Webber Mitchell Hutchins Inc., Paine Webber Real Estate Securities Inc. and Rotan Mosley Inc. CIGNA Corp., through subsidiaries, is the beneficial owner of approximately 15.3% of the outstanding common stock of Paine Webber, Incorporated, and of 100% of the outstanding Series D preferred stock of Paine Webber, Incorporated.

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CONSTITUTIONAL PROVISION INVOLVED

Supremacy Clause of the United States Constitution (art. VI, cl. 2):

> This constitution, and the laws of the United States which shall be made in pursuance thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, any thing in the constitution or laws of any state to the contrary notwithstanding.

STATEMENT OF THE CASE

This case involves the direct conflict between a so-called "anti-Waiver" provision contained in the Wisconsin Uniform Securities Law (§ 551.59(8), Wis. Stats.) and Sections 2 and 3 of the Federal Arbitration Act. The Wisconsin statute, as applied by the United States District Court for the Eastern District of Wisconsin in this case, but reversed on appeal, would negate plaintiff's agreement to arbitrate her state claims based on purchases and sales of securities for her discretionary brokerage account in Palm Beach, Florida.[1] The Arbitration Act requires that these claims be arbitrated.

Plaintiff commenced this action in the Circuit Court for Milwaukee County, Wisconsin, against Paine Webber Jackson & Curtis Incorporated ("Paine Webber") and Steven Mait, a former employee of Paine Webber who managed plaintiff's discretionary brokerage account in Florida. Plaintiff seeks to recover for losses in her account under both the Wisconsin Uniform Securities Law and Wisconsin common law. She makes no claim under the federal securities laws.

The first cause of action alleges that plaintiff was damaged because Mait, Paine Webber's agent, in effect bought and sold securities in Wisconsin in violation of state licensing requirements (§§ 551.31(1) and (2), Wis. Stats.). The second claim alleges that, because Mait was not licensed in Wisconsin, the brokerage agreement between the parties was void and subject to rescission. The remaining three claims allege liability under common-law theories. The liability of Paine Webber is alleged under a "controlling person" provision of the Wisconsin

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[1] Whether the state statute has this effect, in absence of a decision by the Wisconsin Supreme Court, is discussed herein at pp. 10-12, *infra*.

Uniform Securities Law (§ 551.59(4), Wis. Stats.) and the common-law theory of *respondeat superior*.

Defendants removed the action to the United States District Court for the Eastern District of Wisconsin on the basis of diversity. They answered the complaint and moved to stay the proceedings and compel arbitration pursuant to Section 3 of the Federal Arbitration Act. The basis of defendants' motion was the provision in plaintiff's written brokerage agreement which required arbitration. (App. D-3.)

In its decision denying the motion, the District Court expressly conceded that the state "anti-waiver" provision conflicted with "a strong federal policy favoring arbitration expressed in the generalized Federal Arbitration Act" and that its decision was "in apparent conflict with a number of district court decisions by its colleagues . . . in the Eastern District of Wisconsin."[2] (App. D-11, 12.) Nevertheless, the District Court undertook its own analysis of federal securities law and state policies to conclude that the "anti-waiver" provision was not preempted. The District Court could find no intention by Congress to preempt conflicting state "anti-waiver" provisions and doubted the "efficacy of . . . [the] reasoning" that Congress created a body of federal substantive law when it enacted the Federal Arbitration Act. (App. D-9, 11.)

The United States Court of Appeals for the Seventh Circuit reversed, holding that there was an "actual,"

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[2] The conflicting decisions to which the District Court referred are *Bache Halsey Stuart Shields, Inc. v. Moebius*, 531 F. Supp. 75 (E.D. Wis. 1982), *Barron v. Tastee Freez International, Inc.*, 482 F. Supp. 1213 (E.D. Wis. 1980), and *Romnes v. Bache & Co.*, 439 F. Supp. 833 (W.D. Wis. 1977). The courts in all three cases recognized the supremacy of the Federal Arbitration Act.

"naked and irreconcilable conflict" between the state statute and the Arbitration Act, that compliance with both provisions was a "physical impossibility," and, therefore, pursuant to unequivocal authority of this Court, the Arbitration Act preempted the state provision under the Supremacy Clause.[3] (App. A-2, 12.) Quoting from *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, — U.S. —, 103 S.Ct. 927 (1983), the Court of Appeals recognized, contrary to the District Court, that the Federal Arbitration Act created *"a body of federal substantive law* of arbitrability" and constituted "a congressional declaration of liberal federal policy favoring arbitration agreements, *notwithstanding any state substantive or procedural policies to the contrary."* (App. A-8, emphasis in original.)

On remand, the Court of Appeals directed that plaintiff's claims under the Wisconsin Uniform Securities Law be arbitrated. The Court of Appeals further directed the District Court to consider whether plaintiff's common-law claims for alleged mismanagement of her account must also be arbitrated under her agreement. (App. A-5 n. 2.)

Plaintiff then petitioned for rehearing and suggested rehearing *en banc*. The Court of Appeals denied the petition on September 2, 1983, after no judge in active service requested a vote on the petition and all judges on the original panel voted to deny rehearing.

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[3] The dissenting judge of the Court of Appeals also recognized the conflict between the two provisions but concurred with the District Court's conclusion that Congress did not "clearly" intend preemption of the state provision. (App. A-13, 14.)

REASONS FOR DENYING CERTIORARI

I. The Issue of Federal Preemption Presented Here Is Neither Novel Nor Unsettled.

Plaintiff argues that this Court should grant review because she presents a novel and important question which has not been decided. Defendants respectfully assert that the question at the heart of this case is anything but novel. It is merely one variation of a question which this Court has answered numerous times. Indeed, presently pending before the Court is a case in which the constitutional issue is indistinguishable from that involved here.[4]

The issue in this case is whether the Supremacy Clause mandates that, where a state law is in direct conflict with a federal law such that compliance with the requirements of both is a physical impossibility, the federal law must prevail. Plaintiff argues, however, that this issue has never been decided by this Court because the Court has never applied the Supremacy Clause to the specific two laws which stand in conflict. Plaintiff argues that the cases involving the Federal Arbitration Act in which this Court has applied the Supremacy Clause are of no precedential value because the decisions did not involve state securities laws.

The fallacy in plaintiff's argument is her assumption that analysis under the Supremacy Clause must yield different results depending upon the particular state laws involved. She argues, for instance, that two decisions of

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[4] *Keating v. Superior Court, Alameda County,* 31 Cal.3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982), *cert. granted sub. nom. Southland Corporation v. Keating,* No. 82-500 (January 10, 1983). Oral argument was presented to the Court on October 4, 1983.

this Court which deal specifically with preemption of state laws which conflict with the Federal Arbitration Act[5] "are of no help in determining the question of preemption" because they involve "run-of-the-mill commercial disputes." (Petition, pp. 21-22.) Additionally, she denegrates the Court of Appeals' application of this Court's decision in *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963), because the decision involved "avocado laws." (Petition, p. 21.) Plaintiff also ignores the other Supremacy Clause cases relied upon by the Court of Appeals in ruling that the Arbitration Act preempted the conflicting state law.[6]

Plaintiff attempts to divert attention from the conflict between the Federal Arbitration Act and the Wisconsin "anti-waiver" provision by discussing the "complementary" relationship between federal and state securities laws and how, in her view, that relationship has been severely altered by the Court of Appeals' decision. Thus, plaintiff finds a novel and important issue which she urges the Court to review.

Defendants respectfully submit that the Court of Appeals correctly defined and decided the issue. There is "a naked and irreconcilable conflict" between a precise federal mandate to arbitrate and a state provision which,

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[5] *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, — U.S. —, 103 S.Ct. 927 (1983); *Prima Paint v. Flood & Conklin Mfg. Co.*, 380 U.S. 395 (1967).

[6] *Pacific Gas and Electric Co. v. State E.R.C. and D. Comm.*, — U.S. —, 103 S.Ct. 1713 (1983); *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *DeCanas v. Baca*, 424 U.S. 351 (1976); *Free v. Bland*, 369 U.S. 663 (1962); *Castle v. Hayes Freight Lines, Inc.*, 348 U.S. 61 (1954); *McDermott v. Wisconsin*, 228 U.S. 115 (1913).

as applied, prevents arbitration. Thus, the Court of Appeals was required to invoke the Supremacy Clause.

The Court of Appeals declined plaintiff's invitation to examine state policies behind the enactment of Wisconsin's "anti-waiver" statute or to grant a special exception to preemption because of the dual federal-state regulatory scheme in the securities field. Such matters, the Court of Appeals correctly observed, are "essentially irrelevant to the required analysis:"

> . . . [T]he conflict we face is plainly not one of federal arbitration procedures versus Wisconsin substantive securities regulation. The conflict is rather between two *procedural* mandates — one that commands, and the other that prohibits, the arbitration of brokerage contract claims. If the Arbitration Act prevails, Wisconsin substantive securities law remains intact, and would indeed have to be considered by the arbitrator of the dispute here. In short, the real field of analysis here is the set of competing federal and state policies with respect to *nonlegal dispute resolution,* not with respect to *securities regulation.* Accordingly, the district court's citation to the dual federal-state regulatory scheme in the securities field and the Supreme Court's interpretation of the "intention of Congress concerning the sale of securities" in *Wilko v. Swan,* 346 U.S. at 427, 438, is essentially irrelevant to the required analysis. (App. A-10, 11, emphasis in original.)

Recent pronouncements by this Court likewise leave little doubt as to proper application of the Federal Arbitration Act and eliminate any need for review in this case. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., supra,* the Court unequivocally stated that Section 2 of the Federal Arbitration Act "is a congressional declaration of a liberal federal policy favoring arbitration agreements, notwithstanding any state sub-

stantive or procedural policies to the contrary." 103 S.Ct. at 941. This explanation, and the recognition that Congress intended "to mandate enforcement of all covered arbitration agreements," 103 S.Ct. at 942 n. 34, is dispositive of the issue here.

Plaintiff's exaggerated claims that the Court of Appeals "struck a damaging blow to the enforceability of the securities laws of at least 37 states" (Petition, p. 26), and that the effect will be "to stultify the development of the state portion of the federal-state regulation of securities" (Petition, p. 28), are unsupported and unjustified. The ruling below in no manner circumscribes the power of the states to enact and enforce their own securities laws and regulations. As the Court of Appeals carefully explained, its decision does not deal with substantive state securities laws, which remain "intact." (App. A-10.) The decision deals only with the *procedure for dispute resolution* in those cases where the parties have agreed to arbitrate their differences. The Court of Appeals' decision promotes the federal law, defendants submit, by "establishing and regulating the duty to honor an agreement to arbitrate." *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., supra,* 103 S.Ct. at 942 n. 32.

This case is also of no pressing importance because, as noted by plaintiff in her Petition, the Court has heard oral argument in *Keating v. Superior Court, Alameda County, supra. Keating* involves a determination by the California Supreme Court that the "anti-waiver" provision of the California Franchise Investment Law created an exception to the Federal Arbitration Act.[7] An

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[7] The *Keating* case also stands in a better posture for review than this case because the California Supreme Court in *Keating* ruled upon the interpretation of the state "anti-waiver" provision.

opinion in *Keating* may well obviate any need for review in this case.

Plaintiff's other claim of importance rests upon a mistaken and unworthy mistrust of arbitration. She asserts, without authority, that arbitration of state securities claims will "frustrate" the law. (Petition, p. 26.) She would do away with arbitration in all securities cases. This stance is unjustified and indeed has been criticized by the Securities Exchange Commission ("SEC").

In three Exchange Act Releases promulgated within the last four years,[8] the SEC has continuously supported arbitration under the Code of Arbitration (the "Code") which has been adopted by all of the securities industries self-regulatory organizations. Contrary to plaintiff's hostility to arbitration, the SEC has found "that the Code was designed to promote just and equitable principles of trade:"

> [The SEC] continues to support the use of arbitration as an important means for the resolution of disputes between broker-dealers and their customers. The Code provides an economical alternative to litigation and fair and efficient procedures for the resolution of these disputes. Securities Exchange Act Release No. 19813 (May 26, 1983), 48 F.R. 24728 (June 2, 1983).

As recently as November 18, 1983, the SEC again noted its "traditional strong support for the use of arbitration for the resolution of disputes that may arise between

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[8] Securities Exchange Act Release No. 20397 (November 18, 1983), 48 F.R. 53404 (November 28, 1983); Securities Exchange Act Release No. 19813 (May 26, 1983), 48 F.R. 24728 (June 2, 1983); Securities Exchange Act Release No. 16390 (November 30, 1979), 44 F.R. 70616 (December 7, 1979).

broker-dealers and their customers." Securities Exchange Act Release No. 20397 (November 18, 1983), 48 F.R. at 53406 (November 28, 1983).

Plaintiff's claims are precisely the type of dispute which the SEC recognizes should be resolved by arbitration. This case exemplifies the benefits to the parties, the general public and the judicial system from the use of arbitration.

Plaintiff's complaint does not affect a broad range of public interest. The resolution of her claims for money will have little, if any, precedential value and will have no effect beyond the immediate parties. The advantages to plaintiff and defendants alike are obvious, although ignored by the plaintiff. Arbitration is speedier, simpler, more informal, more efficient and private. Arbitration is also far less expensive than litigation, as this two-year old case demonstrates.

II. Review May Be Premature Where the Preempted State Statute Has Not Been Construed by the Wisconsin Supreme Court.

The issue raised here may be premature for determination by this Court. In its opinion, the District Court noted plaintiff's argument that Section 551.59(8), Wis. Stats., which evolved from Section 410(g) of the Model Securities Act, was intended by the Wisconsin Legislature to be interpreted as this Court interpreted Section 14 of the Federal Securities Act of 1933, 28 U.S.C. § 77n, in *Wilko v. Swan,* 346 U.S. 427 (1953). The District Court never discussed the merits of this argument. It made no reference to legislative history and apparently assumed that Section 551.59(8), Wis. Stats., *must* be interpreted the same as Section 14 of the 1933 Act.

The infirmities of plaintiff's argument are three-fold. First, the authority cited by plaintiff in support of her assertions as to the history of Section 551.59(8), Wis. Stats., and Section 410(g) of the Model Act, is III Loss, *Securities Regulation* (1961). (Petition, p. 9.) However, that authority does not remotely suggest that Professor Loss even considered *Wilko v. Swan* when drafting Section 410(g). He does not once mention the case in connection with Section 410(g), and, in fact, takes a neutral view of *Wilko v. Swan.*

Second, even assuming Professor Loss' intention, there is no indication of a similar intent by the Wisconsin Legislature. The only legislative comment regarding Section 551.59(8), Wis. Stats., is the statement in Wisconsin Senate Bill No. 26 (1969) that Section 410(g) corresponds to Section 189.18(5) of the former Wisconsin Securities Law "which makes ineffective any waiver of a repurchase offer." There is no mention of arbitration, *Wilko v. Swan,* or Section 14 of the 1933 Act.

Third, the regulations of the Wisconsin Commissioner of Securities, which are issued under the Wisconsin Uniform Securities Law, specifically provide for arbitration. The regulation (Wis. Adm. Code SEC § 9.01(1)(b)2) incorporates the Commissioner's Form U-4 and requires that any applicant registering as a securities broker in Wisconsin certify that he or she agrees "to arbitrate any dispute, claim or controversy that may arise between me and my firm, or a customer, or any person, that is required to be arbitrated under the rules, constitutions, or by-laws of the [self-regulatory bodies] with which [the agent] register[s]." This declaration by the Wisconsin administrative agency charged with responsibility for enforcing the state's securities laws directly contradicts plaintiff's argument.

Where the Wisconsin Supreme Court has yet to interpret Section 551.59(8), Wis. Stats., defendants assert that it would be premature to resolve an apparent constitutional question which, in reality, may not exist.

CONCLUSION

Because plaintiff has failed to demonstrate that the issue decided by the Court of Appeals is either novel, important or unsettled, and in view of the pendency in this Court of *Keating v. Superior Court, Alameda County, supra,* and the uncertainty regarding the correct interpretation of the Wisconsin statute, defendants respectfully submit that certiorari should be denied.

Respectfully submitted,

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